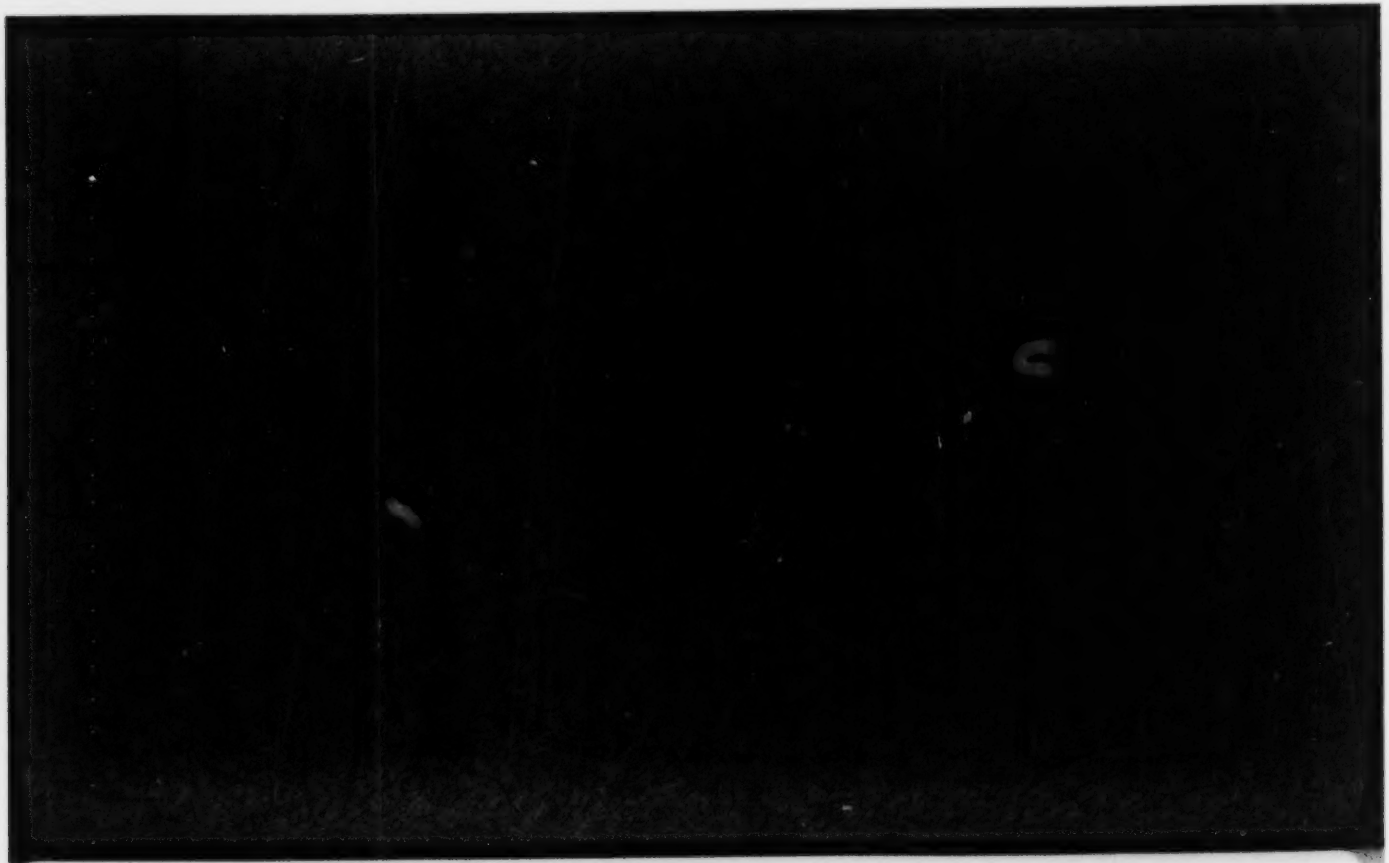

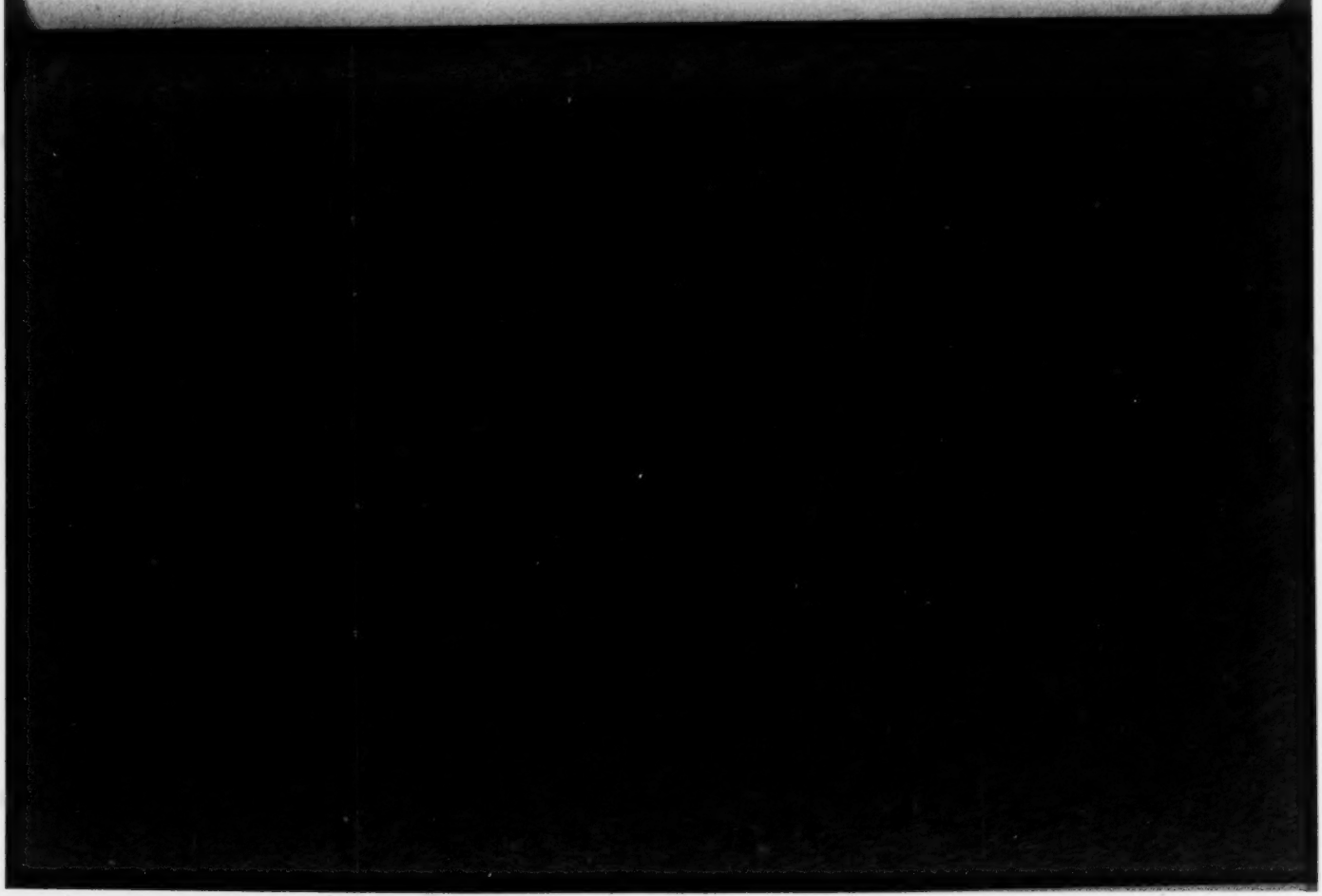

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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 126

AVIATION CAPITAL, INCORPORATED (IN LIQUIDATION), PETITIONER

v.

WILLIAM J. PEDRICK, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF NEW YORK

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 92–99) is reported in 56 F. Supp. 964. The opinion of the Circuit Court of Appeals and the concurring opinion (R. 109–114) are reported in 148 F. 2d 165.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 5, 1945 (R. 114). The petition for a writ of certiorari was filed on June 13,

1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether, on a sale by the taxpayer corporation of shares of its own stock which it had previously purchased, the profit constitutes income within the meaning of Section 22 (a) of the applicable revenue statutes and regulations, when the sale was made to acquire working capital.

2. Whether the Treasury Department had power to promulgate the rule adopted by these regulations as applied to transactions consummated thereafter, notwithstanding the fact that earlier regulations had provided that corporations realized no profit in dealing in their own stock and Congress had previously reenacted the statutory definition of gross income.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.—"Gross income"* includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also

> from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.* * *
>
> * * * * *

The corresponding provisions of Section 22 (a) of the Revenue Act of 1938, c. 289, 52 Stat. 447, and the Internal Revenue Code are identical.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

> ART. 22 (a)–16. *Acquisition or disposition by a corporation of its own capital stock.*— Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.
>
> But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration

> upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Act.

Article 22 (a)–16 of Treasury Regulations 101, promulgated under the Revenue Act of 1938, and Section 19.22 (a)–16 of Treasury Regulations 103, promulgated under the Internal Revenue Code, are identical.

STATEMENT

The facts as found by the Tax Court are, in substance, as follows:

The taxpayer, Aviation Capital, Incorporated, was organized under the laws of Delaware on April 20, 1929. On or about August 29, 1942, it was duly dissolved, but by the statutes of the State of Delaware it continued to be a corporate body for the purpose of prosecuting and defending suits, and of enabling it to settle and liquidate its affairs. Prior to its dissolution it was engaged in the business of purchasing, holding, selling and dealing in the capital stock and other securities of aviation companies. (R. 92–93.)

The taxpayer's certificate of incorporation required the taxpayer, upon demand, to purchase its stock from its stockholders at a purchase price

based upon the current net worth of the taxpayer's assets at the time of demand according to a formula therein provided. With respect to such stock, the charter provision provided (R. 93):

> Stock of the corporation acquired by the corporation shall not be thereby cancelled or retired, but may be reissued; provided, however, that the corporation may reduce its stock in the manner authorized by law and effect such reduction by the cancellation and retirement of any shares of its stock held by it.

Pursuant to these provisions, the taxpayer, from 1929 to 1939, purchased shares of its stock which it held in its treasury but later resold, in 1937, 1938 and 1939, for a higher aggregate amount (R. 93).

Upon the issue of its stock by resolution of the board of directors, the taxpayer regularly allocated the sales price thereof in excess of par value to paid-in surplus. Upon the purchase of its stock, the taxpayer charged paid-in surplus with the purchase price in excess of par value. Upon sale of its treasury stock, the taxpayer credited paid-in surplus with the sales price in excess of par value. (R. 94.)

The purchases of its stock were made by the taxpayer only when required to do so by its stockholders, and were in fact made at its current liquidation value in accordance with the formula contained in its certificate of incorporation. The sales by the taxpayer of its stock in 1937, 1938

and 1939 were made in order to raise much needed working capital. At the time of such sales, the taxpayer had available authorized but unissued stock which it could have sold. (R. 94–95.)

The taxpayer, in purchasing its own stock, handled the transaction on its books differently from the way it handled the purchase of other stock. In the purchase of other stocks, there was no change in the company's net worth but merely a change in form of assets, from dollars to investments. In the purchase of its own stock there was a reduction of the company's net worth in that the stock so purchased was not carried as an asset or as having any value, although it was not cancelled or retired. The company paid itself no dividends on such treasury stock. When the company sold its own stock so acquired, the excess of the proceeds over par went to surplus account, increasing the company's net worth. In the sale of other stocks the profit or loss therefrom went into income account. The sale of the treasury stock had the same effect on the books of the company as if unissued stock had been sold. (R. 95.)

The taxpayer declared a one hundred per cent (100%) stock dividend on June 17, 1940. This dividend was paid on June 18, 1940. The following is the resolution of the board of directors of the taxpayer declaring the dividend (R. 96–97):

> After motion duly made, seconded and unanimously adopted it was

> RESOLVED, That a 100% stock dividend in the stock of the Company be and the same hereby is declared on all stock of the Company, including Treasury stock, on record at 3:30 P. M. Eastern Daylight Saving Time on June 17, 1940, said dividend to be payable June 18, 1940; and
>
> FURTHER RESOLVED, that for the purpose of the foregoing resolution stock of record shall be deemed to include any share of stock which a purchaser shall have become obligated to purchase from the Company prior to the record date and hour, but for which no certificate shall have been issued at that time, and further that on any share which at the record date and hour the Company shall have become obligated to repurchase, such dividend shall be payable to the Company as in the case of Treasury stock; and
>
> FURTHER RESOLVED, that the par value $1.00 per share for the shares issued for such stock dividend (less the par value of shares payable on Treasury stock) be charged to paid in surplus.

Pursuant to the resolution, the taxpayer allocated 400 shares of its stock to treasury stock. (R. 97.)

The District Court (R. 97–99) and the Circuit Court of Appeals (R. 109–113) held that the Treasury Regulations covering the transaction were valid, and that the sale of taxpayer's repurchased stock at a profit constituted income within the meaning of Section 22 (a) of the Revenue Acts.

ARGUMENT

1. The decision of the court below is correct and does not involve any extension of the scope of the regulations (cf. Br. 11). The petitioner's contention (Br. 14, 17–18) that the sale of the Treasury stock to obtain working capital was only a capital transaction and that the regulations do not and cannot apply to such a situation has been rejected in *Allen* v. *National Manufacture & Stores Corp.*, 125 F. 2d 239 (C. C. A. 5th), certiorari denied, 316 U. S. 679. See also *Dow Chemical Co.* v. *Kavanagh*, 139 F. 2d 42 (C. C. A. 6th). Moreover, the contention is unsound. Working capital may be obtained by a sale of fixed assets which have appreciated in value, but no one would argue that income within the meaning of the Sixteenth Amendment has not been received.

The fact that the transaction may be treated as a capital transaction for accounting purposes is not controlling. That conservative accounting may relegate to capital what constitutionally is income or earnings or profits does not circumscribe the reach of the Revenue Acts. *Helvering* v. *Reynolds Co.*, 306 U. S. 110, 114. See also Section 115 (h) (1) of the Internal Revenue Code (26 U. S. C. 115); *Commissioner* v. *Sansome*, 60 F. 2d 931 (C. C. A. 2d), certiorari denied, 287 U. S. 667; and *Commissioner* v. *Wheeler*, No. 354, October Term 1944, decided March 26, 1945.

Nor is there any merit to the contention that the situation is no different than it would be if the corporation had retired the repurchased stock and

issued authorized but previously unissued stock which, under the regulations, results in no income. Important legal and practical distinctions exist between the sale of treasury stock and the retirement of repurchased stock accompanied by the issuance of authorized but previously unissued stock. The purchase by a corporation of its shares without retirement enables it to avoid compliance with statutory or charter requirements that a reduction in capital stock be effected by vote of the board of directors and of the stockholders, and the filing of public notice; such purchase without retirement may also enable the corporation to sell the shares without observing the preemptive right of shareholders. A corporation which is enabled to secure these advantages by refraining from retiring its stock cannot properly urge that what it did was tantamount to retirement and reduction of capital and the subsequent issuance of newly authorized stock. (Cf. Br. 14.) Moreover, these advantages serve to point up the similarity between the transaction here and a transaction whose subject matter is the stock of another corporation, not taxpayer's own. See Article 22 (a)–16 of Treasury Regulations 94, *supra*, p. 3.

Finally, the decision of this Court in this case would not, contrary to petitioner's suggestion (Br. 11), afford an appropriate occasion for this Court to define the limitations of the regulations as applied to other situations.

2. The petitioner contends that Treasury Regulations, promulgated under earlier statutes and providing that a corporation realizes no gain or loss from dealing in its own shares, became so embedded in the law by the reenactment of the section defining gross income that the Treasury had no power to prescribe a different rule for the future and, hence, that Article 22 (a)–16 of Treasury Regulations 94, promulgated under Section 22 (a) of the Revenue Act of 1934, and the corresponding regulations under the Revenue Act of 1938 and the Internal Revenue Code are invalid. This Court has denied petitions for writs of certiorari in several cases in which substantially the same contentions have been made (see *Allen* v. *National Manufacture & Stores Corp.*, 125 F. 2d 239 (C. C. A. 5th), certiorari denied, 316 U. S. 679; *Commissioner* v. *Air Reduction Co.*, 130 F. 2d 145 (C. C. A. 2d), certiorari denied, 317 U. S. 681; *Helvering* v. *Edison Bros. Stores*, 133 F. 2d 575 (C. C. A. 8th), certiorari denied, 319 U. S. 752) and, there is no conflict on this issue. The validity of the amended regulations as applied to transactions consummated after the amendment[1] has been upheld in every circuit in which

[1] The Regulations were amended in 1934 by T. D. 4430, XIII–1 Cum. Bull. 36 (1934). In *Helvering* v. *Reynolds Co.*, 306 U. S. 110, this Court held the amended regulation invalid as applied to transactions consummated before the amendment, but did not pass upon its validity as applied to transactions effected thereafter.

the issue has been litigated and by the Court of Claims. In addition to cases cited above, see *Dow Chemical Co.* v. *Kavanagh,* 139 F. 2d 42 (C. C. A. 6th); *Wiegand Co.* v. *United States* (C. Cls.), decided May 7, 1945 (1945 C. C. H. Tax Service, par. 9286). Moreover, the power of the Treasury Department to make prospective amendments to Treasury Regulations, notwithstanding reenactment of the statute after the adoption of the prior regulation, has been firmly established by decisions of this Court. *Commissioner* v. *Wilshire Oil Co.,* 308 U. S. 90; *Helvering* v. *Reynolds,* 313 U. S. 428; *White* v. *Winchester Club,* 315 U. S. 32.

CONCLUSION

The decision below is correct, and there is no conflict which needs to be resolved nor any occasion for further review of the issue. The petition should therefore be denied.

Respectfully submitted.

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